UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES AND EXCHANGE COMMISSION

Plaintiff,

v. 18 Civ. 8175 (ER)

BARRY C. HONIG, et al.,

Defendants.

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New York, N.Y.
November 7, 2019
4:45 p.m.

Before:

HON. EDGARDO RAMOS

District Judge

APPEARANCES

NANCY BROWN
JACK KAUFMAN
Attorneys for Plaintiff SEC

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BY: CHRIS JOHNSTONE

(In open court)

THE COURT: Good afternoon everyone. Please be seated.

(Case called)

MS. BROWN: Good afternoon, your Honor. Nancy Brown and Jack Kaufman for the plaintiff.

THE COURT: Good afternoon.

MR. RICHARD: Dennis Richard for the defendants Michael Brauser and Grander Holdings.

MR. LEE: Good afternoon, your Honor. Randall Lee and Michael Berkovitz from Cooley for defendant Mr. Ladd.

MR. JOHNSTONE: Good afternoon, your Honor. Chris Johnstone of WilmerHale for the defendant Mr. Ladd.

THE COURT: And good afternoon to you all. So, this matter is on for premotion conferences. There are a couple of requests from Mr. Ladd and one from Mr. Brauser. So, let me begin with counsel for Mr. Ladd, Mr. Lee.

MR. LEE: Thank you, your Honor. There are essentially two major categories of discovery requests at issue here. The first is SEC e-mails and documents, which I will address; and the second are F.B.I. 302s, which Mr. Johnstone will address.

So, on the first sort of category -- and I will go through the buckets, the first category of requests -- I would like to briefly address the regulatory background underlying

the purpose for the request, because I think the regulatory background illustrates the relevance and the importance of the particular requests that we've made.

The essence of the SEC's case against Mr. Ladd and others arises from Section 13(d) of the Securities and Exchange Act of 1934, which was adopted as part of the Williams Act, which was essentially designed to put issuers and market participants on notice of potential take-over attempts.

There is a section in Section 13, Section 13(d), which requires any "person" who acquires more than five percent of a class of equity securities to file a form known as a schedule 13(d) upon the acquisition of such ownership. That requirement, as the language makes clear, applies to any person. Section 13(d) then provides: When two or more persons act as a partnership, limited partnership, syndicate or other group, for the purpose of acquiring, holding or disposing of securities of an issuer, such syndicate or group shall be deemed a person.

And then there is a rule promulgated under Section 13(d), Exchange Act Rule 13(d)(3), which includes a number of provisions that define when a beneficial owner of a security, who that beneficial owner is for purposes of the 13(d) disclosure requirements.

So, for example, Rule 13(d)(3) specifies: When two or more persons agree to act together for the purpose of

acquiring, holding, voting, or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership of the securities of all the members of that group.

13(d)(3) also goes on to provide, however: That a group shall be deemed not to have acquired any equity securities owned by other members of the group solely by virtue of concerted actions relating to the purchase of equity securities directly from an issuer, provided that certain conditions are met.

The essence of the SEC's claim here as to one sort of big chunk of their complaint is that certain of the defendants led by defendant Barry Honig constituted a group as that term is defined in Section 13(d), that those investors -- Mr. Honig and others -- should have filed a schedule 13(d) disclosing their aggregate holdings as a group, and that our client, Mr. Ladd and MGT Capital -- the company of which he was CEO -- knew or were reckless in not knowing that Mr. Honig and the other defendants were a group and that they should have identified them as such in their securities filings.

And the definition of a group is particularly important or critical here because Barry Honig -- who has been described by the SEC as really the orchestrator of the series of fraudulent schemes that are alleged in the complaint -- Barry Honig did disclose that he was more than a five percent

shareholder. So, the SEC's theory is that he and others should have together disclosed an even greater percentage of share ownership than the five percent that Mr. Honig already disclosed.

So, really the reason for our request -- and the regulatory and statutory scheme should make clear -- the law is extremely complicated, it's ambiguous.

THE COURT: Any case law?

MR. LEE: There is case law on it. So, the SEC has promulgated virtually no guidance -- essentially we are been able to find -- on how you define a group. There is case law on it; the case law is mixed. The case law varies.

THE COURT: What's the case law in this Circuit? Is it mixed in this Circuit?

MR. LEE: The case law looks essentially at an inquiry as to whether the alleged or purported members of the group formed an agreement to vote, dispose of, and so on, their shares, and it turns into a highly fact-specific analysis. But for an issuer of securities like MGT, what the SEC has not explained -- and what the case law we have not been able to find guidance on -- say absolutely nothing about what the level of due diligence an issuer is supposed to conduct about its own investments.

So, for example, is it sufficient for an issuer to rely on representations from its investors if hypothetically

Mr. Honig had informed MGT that he was not part of a group, was MGT required to look beyond that representation and do its own due diligence to get behind his representations in the application of the group? There is no guidance on that from the SEC, and there is very little case law on that issue as to whether an issuer is required to look at and do due diligence at a composition of a group of investors in that issuer.

THE COURT: Let me ask it this way: Are there cases within the Second Circuit or the Southern District that address the issue that you are talking about?

MR. LEE: There may be. Not that I'm immediately aware of.

THE COURT: There may be, and so there may be some dispositive case out there that I would have to follow, and would that take of this entire issue?

MR. LEE: I would submit that is not the case, because it's a fact that -- the case law is clear, it's a highly fact-specific as to whether an agreement was formed. And that's the essence of sort of the group principle, that investors who invest side by side with one another, the presence of a lead investor, investors who share ideas, investors who say, hey, what are you investing in, that sounds look a great investment, I would like to do the same thing, that is not a group. A group requires a specific agreement to vote together, to dispose of shares together, to buy shares

together.

THE COURT: So let me ask this: As I understand it, what you are looking for are statements of individual SEC high-level employees or SEC commissioners concerning that issue, correct?

MR. LEE: We're looking for essentially three categories. Number one is we're asking the SEC to prepare a privilege log of internal communications concerning the SEC's application and interpretation of the group rules. The SEC has declined to produce a privilege log. They have objected on grounds of relevance; they have objected on grounds of burden.

As to relevance, it's plainly relevant to recklessness and scienter; it's relevant to whether the defendants have a fair notice defense; and it's relevant to injunctive relief.

As to burden, we as recently as yesterday proposed to the SEC a narrowing of search terms in order to try to generate a more manageable number. The SEC has claimed that the search terms we initially discussed yielded 26,000 e-mails, all of which were ostensibly covered by one single entry in that privilege log. The SEC said that's too burdensome. We then had a discussion with them a couple days ago about a proposal to narrow that, under which proposal if the search term hits were reasonable in number, the SEC would prepare a document-by-document privilege log, which would then give us the ability to challenge the privilege assertions.

THE COURT: OK.

MR. LEE: We made a proposal to the SEC yesterday, and we have not heard back from them on a set of search terms.

THE COURT: Ms. Brown?

MS. BROWN: Your Honor, I actually thought this issue, the latter one we're talking about about the e-mails and the privilege log, was still under discussion with defendants, so I'm prepared to discuss it with them.

THE COURT: Great. So, I don't have to engage in this discussion any further. Next issue.

You should still meet and confer concerning that issue, and if you don't agree, then you can come back.

MR. LEE: OK.

THE COURT: Okay?

MR. LEE: OK. Next issue was a privilege log of internal communications within the SEC's Division of Corporate Finance -- which is the division that reviews public company filings -- concerning MGT, the very company at issue here. We asked the SEC -- the SEC has again objected to the notion of preparing a document-by-document privilege log. In the last meet and confer we had with them we asked them, well, how many hits are there; is it unduly burdensome?

THE COURT: So, what you want is documents concerning internal communications within Corp Fin of MGT.

MR. LEE: About MGT's filings during the relevant time

period.

THE COURT: Ms. Brown?

MS. BROWN: Yes, your Honor. I also thought that was the subject of further discussion. But I will say that we also objected on the grounds of relevance, and it was only yesterday or the day before -- I may have the days wrong -- in which the defendant Mr. Ladd offered the relevance ground that it again was all about the uncertainty within the Commission about the definition of group under 13(d).

So, now that I have that representation, we can come with search terms related to that narrowed subsection, but originally it was about all Corp Fin's internal e-mails about MGT's filings. And MGT's filings aren't at issue here except with respect to the disclosure of the group issue.

THE COURT: OK. So, it sounds like we're making great progress, just meet and confer some more.

MR. LEE: Well, and the other issue that would be relevant, the other component of the SEC's claim, relates to certain press release about a deal that MGT entered into with John McAfee, the internet security guru. So, I think that would be another set of search terms as to which communications within Corp Fin, if they had commented on that particular issue in the course of reviewing MGT's filings, would certainly be relevant.

THE COURT: I'm sorry. How is Mr. McAfee relevant to

this case?

MR. LEE: So, the SEC has alleged that MGT made a false statement in a press release -- which was filed as part of a form AK -- announcing a deal that MGT had entered into with John McAfee.

THE COURT: The individual.

MR. LEE: The individual. And the SEC's allegation is that the press release described Mr. McAfee's professional background in a false and misleading planner. And that filing would have been the subject of internal review in Corp Fin, and so that's another -- the group rule and then the McAfee press release are the two sort of substantive issues about which we would be seeking internal communications if they exist.

THE COURT: Ms. Brown?

MS. BROWN: That's a new one to me, your Honor. That was not raised in our call the other day. I am having trouble understanding how Corp Fin's reaction to a press release would be relevant to the SEC's later claim that the press release was false, unless it goes to a claim of laches or estoppel. And those are not appropriate affirmative defenses against the SEC.

MR. LEE: Your Honor, it would certainly be relevant. It could be. We don't know because the SEC hasn't produced a privilege log. But if there were comment on the accuracy of that press release, that could certainly be relevant to Mr. Ladd's scienter. If, for example, somebody at Corp Fin had

commented, hey, did John McAfee really do this and that, and somebody else from Corp Fin wrote, you know, no, his background is a matter of public knowledge, that would be --

THE COURT: I have to say I'm having difficulty following the relevance here.

MR. LEE: I'm happy to break it down further, your Honor.

THE COURT: Take a minute to do that.

MR. LEE: OK. So the allegation in the complaint is that MGT falsely stated that John McAfee had sold -- back up. The backdrop is a deal that MGT and Mr. McAfee are entering into. The alleged false statement is a statement that John McAfee, the visionary Internet security pioneer, sold his company to Intel for $7.6 billion. That statement was inaccurate. In truth the company that bore his name was sold to Intel after Mr. McAfee had already left the company. So McAfee Associates was in fact sold to Intel for $7.6 billion. Mr. McAfee the individual was no longer CEO of the company at the time it was sold. That's the essence of the SEC's false statement allegation.

THE COURT: I'm sorry. Ms. Brown, how does all of this fit in?

MS. BROWN: I don't know, your Honor. I mean I know what the false statement is, and I know why we claim it's false, and I know why we claim it's material, which is that Mr.

McAfee had left McAfee Associates many, many years prior to the very successful sale of his company. So, our theory is that the press release was misstated in that way intentionally to persuade investors that MGT would similarly have bestowed upon it the magic of Mr. McAfee.

MR. LEE: But the fact that Mr. McAfee had left McAfee Associates was itself a matter of public record. It had already been publicly disclosed in McAfee Associates' own SEC filings.

THE COURT: So your defense is that it wasn't false, and if it was inaccurate it was an innocent error?

MR. LEE: It was certainly an innocent error. I mean if you read the language, we have conceded it is technically inaccurate; he did not personally sell his company. But, as you say, it's an innocent error, and certainly not material, and already had been publicly disclosed and therefore it cannot be an actionable statement.

THE COURT: And that is in the complaint against MGT?

MR. LEE: That is in the complaint against Mr. Ladd.

MS. BROWN: There is no claim against MGT, your Honor.

MR. LEE: Against Mr. Ladd.

THE COURT: So it's in a complaint against Ladd.

MR. LEE: Yes, for having the signed filing that contained that alleged false statement.

THE COURT: OK. So that appears to be somewhat

relevant. Ms. Brown, why don't you give some documents about that?

MS. BROWN: First of all, he is asking for internal documents. Corp Fin --

THE COURT: Well, any documents he is going to ask for are internal documents, right?

MS. BROWN: For today's session, yes, I think. Actually, no, there is a whole other area that isn't internal documents.

So, what Corp Fin employees said about the filing, I'm not sure how that relates to Mr. Ladd's innocent mistake or his intentional false statement. If it's a matter of public record, that's something that the defendant will prove, I'm certain, by lots of other evidence. I think that's the subject of their motion to dismiss. And I just am having trouble understanding how Corp Fin's internal communications -- if there are any -- about that filing have any relevance here.

THE COURT: Describe for me, if you will, the relationship between Corp Fin and the Enforcement Division. I mean that might help me to understand why you think this is a crazy request.

MS. BROWN: Sure. So, Corp Fin is a world unto its own. We do communicate. When they see things that they think are troubling, they can make referrals to Enforcement, but typically what they do is review mostly registration statements

and that kind of thing. Their review of a case -- in fact I don't even think AKs are filed with the Commission; I think they're furnished to the Commission, which is a term of art which does not necessarily require any review. It is simply a company making a public disclosure, and they furnish it to the Commission attached to an AK. So, I honestly sitting here don't know what Corp Fin's view of what its review of those are, but I suspect it's very limited.

Now, again, this was raised for the first time here, so I'm happy to go ask somebody that question and discuss it with the defendants further.

THE COURT: OK. Do Corp Fin and Enforcement talk?

MS. BROWN: Yes. As I said, if Corp Fin sees something in a registration statement, for example, that they think is a materially false statement for whatever reason, or they feel that there is some need for enforcement to take action, they can make referrals.

THE COURT: And are the referrals typically discoverable or turned over in discovery?

MS. BROWN: No.

THE COURT: Why not?

MS. BROWN: It's part of our nonpublic investigative process. So until we decide to actually bring an action, nothing that we do within the SEC's internal processes is considered public.

THE COURT: OK. Well, why don't you find out what there is and let Mr. Lee know what you can. OK?

MR. LEE: That's all we've been asking. At this stage, in this category, all we're seeking is a privilege log. And we understand that the issue of whether documents logged are in fact protected by privilege and is going to be an issue for another day.

THE COURT: OK.

MR. LEE: The next category -- I mentioned there were essentially three categories. The next category of documents that we moved on were statements that SEC officials have made publicly or to third parties about the issue of the interpretation or application of the group rules. And the SEC's response was essentially that there are no such statements because any statements by an SEC official are made in his or her own individual capacity; and, number two, that any public statement or presentation by an SEC official is publicly available on the SEC's website in any event.

We submit that, number one, clearly SEC officials hold themselves out as speaking on behalf of the SEC. Not all public statements include the disclaimer we cited in our reply brief. A number of aspects are elements of the SEC's own website which include public statements that are clearly attributable to the SEC as a whole. And then, number two, it's not in fact true that all public statements by SEC officials

are posted on their website. SEC officials speak at conferences, they speak to industry groups, they make public statements all the time that are not put on the SEC's website.

THE COURT: Let me tell you what little information I have on this topic. I once upon a time was a member of the Department of Justice, not the SEC, and I spoke on any number of panels, and I spoke at any number of ADA white collar conferences, and at each one of those events so did several dozen others of my DOJ colleagues, and to a person whenever we spoke we said I'm here in my individual capacity, I do not speak for the Department of Justice; if you want the Department of Justice view, go to the Attorney General.

And I imagine the way that it's been described to me that the same is true of the various SEC statements that you're seeking, that any individual -- and, by the way, there were also SEC members on some of those panels, and they said the same thing. And so, therefore, what does it matter what a particular SEC employee said no matter how high within the organization, if at the beginning he or she noted I am here not as a representative of the SEC but as someone that is perhaps knowledgeable on these issues and I am only giving my own views? How is that helpful, relevant, admissible, et cetera? I mean I can see how it's helpful, but how is it relevant or admissible?

MR. LEE: Well, I have several responses. Number one,

certainly the public looks to and market participants look to statements of at least high-ranking officials, whether it's DOJ or the SEC, for guidance. That's why they're posted on the website. If you go to the SEC's website, it's the same as the DOJ website, at least for a certain category of official, their speeches are on the website, and not just for idle curiosity, it's because people look to those statements for guidance, and people view those statements as being made on behalf of those agencies not withstanding the disclaimer.

THE COURT: Guidance has a particular definition, correct?

MR. LEE: I beg your pardon?

THE COURT: The word guidance in SEC rules has a particular definition.

MR. LEE: No, not necessarily. No, guidance just means if the chairman of the SEC -- who clearly is somebody to whom market participants would view as, you know, representing the SEC's views -- said to an industry group, you know what, we know that a lot of you are confused by how to apply Section 13(d), that is certainly relevant to our client's scienter, to recklessness.

THE COURT: Right, but that type of comment at that level within the SEC organization you say is on their website?

MR. LEE: Some are, some are not. It is entirely up to the speaker as to whether they choose to put it on their

website. Not all speakers and presentations are put on the website. I know that from firsthand experience having been at the SEC for a number of years. Sometimes they're on the website, sometimes they're not. Obviously, we can search the website ourselves. What we have asked the SEC to do is for a limited number of officials who are authorized to engage in public speaking -- and it is not a large universe of individuals; it's individuals at a certain rank -- to search for speeches on this topic. It's squarely relevant to at the very least scienter and to recklessness, because the standard of recklessness is defined as an extreme departure from a standard of ordinary care, and so the standard of ordinary care would include what do industry participants view as standard practice.

THE COURT: Ms. Brown?

MS. BROWN: So, the limited number of people that Mr. Ladd suggests we search through, the number of e-mail custodians at my count currently is 96, and that is currently --

THE COURT: But I guess he is not interested in e-mails.

MS. BROWN: Oh, no, he is, your Honor. He is interested -- he wants us to search the e-mails of these individuals for public statements, which I don't know how I would even guarantee that what is in an e-mail is something

that was actually delivered as a public statement or saw the light of day.

But on the other side of that is the fact that it would be extraordinarily burdensome. That's 96 e-mail custodians today. He has asked for it actually without a date limitation, but if we applied a reasonable date limitation that's seven years. I don't know how many multiples of 96 we would have to search in order to capture everyone who has ever held the position that he suggested we search for.

THE COURT: I mean it's 96 with no date restriction. If there were a date restriction it would be fewer, right?

MS. BROWN: No, it's 96 today. So, there are 96 officers, senior officers and division heads that he has asked for, and commissioner counsel and commissioners. That's 96. Those people change, so last year it's still 96 but it could be completely different individuals, and we would have to go get their e-mails. And then I don't even know that their e-mails will tell us whether the statements that are contained in there are actually public statements.

THE COURT: Mr. Lee, that sounds burdensome to me.

MR. LEE: We have not specified that the search for public statements would need to include an e-mail review. Certainly the SEC could reach out to -- you know, could make inquiry of the relevant officials and ask them please provide us copies of all speeches and public statements you made in the

last X number of years on the topic of Section 13(d).

THE COURT: I had to do that when I went through the confirmation process, find copies of all my public statements, and it took me the better part of four months, and I'm just one person. I wasn't doing just that for four months, but I was putting together the packet, and a lot of it was trying to figure out when I spoke, where I spoke, what I said, do I have notes, is there videotape of it, et cetera, et cetera. It is an incredibly burdensome process to do. You know, there might be some category of document out there that -- I don't know, I suppose you could review their website as good as anyone else, but I don't know how they might limit that search in a way that would not be burdensome, including upon former SEC officials.

MR. LEE: Again, your Honor, I think a couple things. Number one, I think the vast majority of the so-called senior officers -- which is the SEC's equivalent of the senior executive service at the SEC -- they're going to know whether they have ever given a speech on Section 13 or not. And I am fairly certain in saying that the vast majority of them have never given a speech on Section 13. So it's an easy inquiry. And, number two, this inquiry is no different from the kind of inquiry that people who prepare deponents for 30(b)(6) depositions have to go through. You have to make reasonable inquiry.

THE COURT: Yes, but when you a 30(b)(6) deposition

you have an individual or two that's identified as an appropriate person to give testimony on that particular topic.

Look, I think at the end of the day even if we could formulate -- and again I don't want to carry your water -- but even if you were to formulate some sort of very limited search or limited in terms of dates, limited in terms of individuals, limited in terms of maybe even something less than 96 individuals, that at the end of the day that you're going to get anything worthwhile, and therefore I find that that request, given the nature of the case, is too broad, too burdensome.

MR. LEE: The last category -- before we get to 302s -- that we're seeking are additional searches of communications with third parties by SEC officials about the application or interpretation of Section 13. This is again a topic that we discussed a couple of days ago. We made a proposal. We have not heard back from the SEC on their response to our proposal as a way to narrow that search. So even after we filed our motion we continue to engage in a meet and confer, but the SEC has not responded.

THE COURT: OK. Well, respond at some point. OK. What else?

MR. JOHNSTONE: I can speak to the 302 issue concisely. As you heard from Mr. Lee, the SEC's case revolves about Barry Honig, who the SEC says orchestrated a fraud

against three public companies. As such, Mr. Honig is the SEC's central witness in this case. What is interesting is that he is taking the Fifth, and thus we have no access to his testimony about what happened.

So the parties on this issue have gone through great lengths to narrow the issues, and it's not a lot of distance between the two of us. We agree with the SEC -- as they said in their letter brief -- that an in camera review of its notes of Mr. Honig's 302s would be an appropriate step forward. The only question is where should the Court draw the line between the portions of those notes that should be produced to us and those that can be withheld.

Our request here is very narrow, that the SEC produce notes of what Mr. Honig said to the government. And we have no interest in their attorney impressions or anything, ideas about what he said.

So, in drawing the line it's helpful to kind of step back and understand why the SEC has notes of Mr. Honig's 302s but doesn't have the 302s themselves. The answer is that the SEC has gone through great lengths here to keep Mr. Honig's statements out of this case. They requested review of the 302s. They sat down, they reviewed them, they wrote their own notes about them. They gave the 302s back to the Department of Justice and then now are withholding those notes from us.

But Mr. Honig's statements about what happened in this

case should be produced. We're not seeking any attorney impressions, but we have a substantial need for what he said about what happened, and we have exhausted all other options -- which is an important point. The SEC did not take any testimony of Mr. --

THE COURT: What have you done?

MR. JOHNSTONE: First I'll say that the SEC did not take investigative testimony of Mr. Honig in this case, so we don't have his statements from that. Second, we served a subpoena on the Department of Justice, with whom we have met and conferred, and they have refused to produce the Honig 302 to us. So we have taken that big step, served the subpoena, meet and conferred with federal prosecutors, and they will not give it to us.

THE COURT: Are there multiple 302s?

MR. JOHNSTONE: There is one 302 listed in the privilege log. I would not be surprised if there are more.

THE COURT: OK. What else?

MR. JOHNSTONE: Third, we have attempted to depose him in this case, and we have heard from his attorney that he intends to assert his Fifth Amendment rights. So, there is no other option for us to go to get his statements about what happened in the case. All we are asking for is what the SEC wrote down about what he said, that's it.

THE COURT: Ms. Brown?

MS. BROWN: Yes, your Honor. Mr. Honig hasn't been deposed yet, so it's news to me that he plans to assert the Fifth. I did not know that. And I'm not sure any of us know that until he sits in the chair or he provides the declaration. That's not to say we shouldn't discuss this issue now.

THE COURT: Remind me, is he under criminal investigation? Has he been indicted? Has he been convicted?

MS. BROWN: I've seen no public record of his criminal status, but he has become a cooperator.

THE COURT: So he is cooperating.

MS. BROWN: Yes.

THE COURT: And you tell me if you -- you know more about this than I do. In such circumstances if the civil related matter is not otherwise stayed, do cooperators testify and give testimony, or do they ask that that deposition be stayed for some period?

MS. BROWN: I think it can vary with the circumstances. It depends what the status of their cooperation is. It depends upon the status of their criminal proceeding. So, if they are sentenced already, they can testify.

So -- and I don't have any idea what he is doing to cooperate, so I don't have much information to share with you. All I know is he has not yet been deposed.

MR. JOHNSTONE: Your Honor, Mr. Honig's attorneys have represented to us that if he is deposed he will assert his

Fifth Amendment rights, so we know that.

THE COURT: OK. And I take it -- again this is more out of curiosity -- that would not be a violation of his cooperation agreement.

MS. BROWN: I don't know, your Honor. I will say so that the Court is clear and so the record is clear, that our notes of 302s -- which themselves as the Court knows are not verbatim notes of what people say -- are highly selective material. We go in and we review the 302s, as Mr. Johnstone just explained, but we don't write down everything that appears in the 302, we write down what is of interest to us.

(Continued on next page)

THE COURT: Why won't you turn that over?

MS. BROWN: Why wouldn't I turn it over?

THE COURT: Yes.

MS. BROWN: Because it's our work product.

MR. JOHNSTONE: Your Honor, they represented in their letter brief they would be prepared to submit it in camera. I think what would be appropriate here is for the SEC to take any notes that they have taken of the Honig 302 and to highlight the things that they believe should not be produced because they are work product, and everything else should be produced to the defense. Mr. Honig is a significant witness in this case. If he ever testifies, we need those statements to impeach him.

THE COURT: If he ever testified, isn't it likely that you would get those statements at some point; not now, but at some point?

MR. JOHNSTONE: We don't know. We don't think we would get them if we were to lose this motion.

Another way to put this is if the SEC were to certify here today that it will not call Barry Honig and will not elicit any sort of testimony from him, then we would reconsider whether we need the notes at all, but we have no visibility into what the SEC wants us to do, so we need his statements to impeach him if he ever testifies.

THE COURT: Ms. Brown, out of curiosity, in a criminal

case, certainly once Mr. Honig takes the stand, the 302 gets turned over, if not shortly before. Does the same thing happen in civil cases?

MS. BROWN: No.

MR. JOHNSTONE: Your Honor, it's a very interesting issue. In criminal cases you're exactly right. Under Rule 16, 302s are produced to the defense, which are grist for cross-examination in the regular course. You see it here every day. The SEC has taken the position in cases across the country that it does into the Brady obligation to provide exculpatory material in a civil case. This is a civil case.

THE COURT: It's more in the nature of Jencks Act material, not Giglio or Brady. So the statement of any witness that takes the stand, generally speaking, to the extent that the notes contain the subject matter of the defendant's testimony gets turned over. Again, I don't know that the SEC would have to turn over the 302s because they don't have the 302s, but I don't know that they would be able to withhold their notes of 302s.

Ms. Brown, what is the typical practice, if you know?

MS. BROWN: Your Honor, we have long held the position that our notes of 302s are not producible. They are our notes. They are our work product. We go to the FBI offices, we look at the 302s, and we taken down non-verbatim notes of things we're interested in.

THE COURT: I take it's SEC attorneys that do that?

MS. BROWN: Yes.

THE COURT: This is an issue upon which it might be evident that I have very little knowledge about, so it would be helpful to me in the first instance if the parties were to submit letter briefs so that when I see the notes in camera I would have a better idea as to what it is I'm supposed to be doing.

MR. JOHNSTONE: Your Honor, we're happy to submit a letter brief on that. We think it makes a lot of sense to submit the notes in camera so you could see what you're looking at.

THE COURT: Ms. Brown, any objection to that?

MS. BROWN: No, your Honor.

THE COURT: Mr. Johnstone, correct?

MR. JOHNSTONE: Yes, your Honor.

THE COURT: When do you want to submit your letter?

MR. JOHNSTONE: In a week.

THE COURT: Okay. Next Thursday.

And Ms. Brown, I will give you a week to respond and submit the letters or the notes in camera. I take it they're not voluminous.

MS. BROWN: No.

THE COURT: Great.

MR. RICHARDS: Your Honor, may I briefly clarify

something on this issue? So the Jencks at does not apply to the SEC.

THE COURT: I understand.

MR. RICHARDS: And the SEC does not abide by Brady either. And so to the Court's question, even if Mr. Honig were to testify in this enforcement action, we would not -- the SEC would not produce any statements by Mr. Honig, any prior statements. So that's why we're seeking this in discovery. It's the only way we can get it.

THE COURT: So this is not new news to you that they would not do that.

MR. RICHARDS: Well, it is just we know from the Jencks Act, it falls under the Federal Criminal Code.

THE COURT: I understand that, but I guess my question is: This has been the SEC's longstanding policy. Presumably, therefore, they have been doing it for years, judges haven't made them turn over these materials, and therefore, you are a petitioner in this area, you should expect that in this case you will likely also not get these materials.

Now I'm learning a lot of this for the first time, so I'm happy to read up on it, but I understand that criminal concepts don't apply to SEC proceedings, I was just analogizing.

Okay. So then we'll get your letter in a week, Mr. Johnstone, and Ms. Brown's response.

MS. BROWN: Are there any replies, your Honor?

THE COURT: Do you want to reply, Mr. Johnstone?

I don't need a reply.

MR. JOHNSTONE: If we believe it's necessary.

THE COURT: Very well. Mr. Richard?

MR. RICHARD: Yes, your Honor, my issues or my client's issues are far simpler.

THE COURT: I certainly hope so.

MR. RICHARD: By way of background, Mr. Michael Brauser is the subject of claims by the SEC that he essentially did three things as to all three companies. Number one, he paid for misleading promotion that artificially increased the sale of the stock. All of the allegations in the complaint as to actual payments of named defendants other than Brauser, so that we're trying to get the evidence of the basis of their saying that. The second one is that he engaged in matched trading, which is a term of art, i.e., he put in an offer to buy stock of each of the three companies, for example, for 75 cents, and there was already another defendant buying it for 75 cents to create an artificial appearance of activity. All of these 75 cent exchanges that are detailed in the complaint are between other defendants. So we're looking for the evidence as to Brauser.

The third thing that they're alleging is that Brauser had an agreement to be part of the group, among whom they

indicate this trading occurred. The SEC's response to our question and as to what we're seeking in discovery is that my client's attorney should search through the 4.2 million pages of documents that the SEC has produced. And their position is that it's our burden to see if I could find the evidence that they needed to have under Rule 11 in order to make those allegations, assuming that they could survive a motion to dismiss without having -- which is before the Court -- specified those payments and those trades in the complaint.

Their position is that they have the right under the production of electronically stored information, ESI, to merely present it in the order in which they keep it. However, in making this argument they're conflating the order in which documents are kept and how they received the documents. So what they're actually saying -- they conceded this -- is that over a period of years we subpoenaed and demanded and asked for documents from over 200 separate persons and entities, and those documents came to us in a haphazard fashion. And we're giving them to you, these four and a half million documents, in exactly the fashion that we received them, not how we keep them.

Now surely the SEC, in all of the years that they have had to go through these documents, and we have only had months, of course, have separated out and organized these documents to determine what claims they have or the basis for the claims

against each defendant, and specifically the basis of the claims against Michael Brauser that he paid promoters, that he engaged in match trades, and that he was part of the aggrieved group. That's fundamentally what we're looking for.

There is a case in this district, in facts it's the single most comprehensive case in the nation, I think it has 97 footnotes on this very issue, *SEC v. Collins*, where they reject the SEC's position and they say that you can't just -- and there I don't think there were 4.2 million documents either. They say that you can't put on the defendant the burden to find the evidence that you needed to know under Rule 11 in order to make the claim, and that you need to be cooperative and you can't basically hide the ball insofar as the defendant. We're a single defendant here that does not have the capacity.

I know they suggested in their letter brief that my law firm has the software to somehow search through the 4.2 million documents. We don't. When you're dealing with documents that are that large, you need substantial major search engines, which means we have to pay outside vendors to look through documents, most of which don't have anything to do with our client.

Now what they say is what you asked for are our entire investigative file, and therefore you got what you asked for. And I said well, could you tell us which of our 14 or 16 requests these production relate to as to Mr. Brauser. And

their response is we're going to designate them all as responsive to your request number one, which is the one that asked for the designated file, and then they stopped sort of the colon after which there are 14 categories of documents that we want within their investigative file. So that's basically what we're looking for.

The case in this district, *SEC v. Collins* also points out that -- and I know that this is still a developing area, because of the shortfalls of electronic discovery what used to be a boxcar of documents can now be a hundred boxcars of documents, and discovery can be weaponized going two ways, both in a demand and in a production. And essentially it's been weaponized here in saying that the SEC will not designate in response to each of our requests.

They're pointing to the subsection of Rule 34 on electronic discovery. What that subsection says and what the committee notes say is it was an effort to provide the same production protection to the parties as paper discovery was. And so basically you can either produce it as kept in the ordinarily course of business, but also has to be reasonably determinable as to what the party that is making the request is looking for. And if not --

THE COURT: Let me stop you, Mr. Richard, because I do at some point have to leave.

Ms. Brown, why can't you be a little more targeted

with respect to Mr. Richard's client?

MS. BROWN: Well, it's interesting, your Honor, we did try. So he told your Honor and he told us that the most important thing was he needed to know where the documents were that related to our allegation that his clients engaged in matched trading. We offered to give him the Bates numbers of those very documents and he declined. So I am happy to certainly meet halfway with defendant to try to help him find documents.

THE COURT: Did he tell you why he was declining your --

MS. BROWN: Because I said I'm trying to make sure that we don't actually have to bother the judge with this, let me give you what you say you really need, which is those documents, and he declined.

I think the reason he declined is because -- and this is my fear about what he's proposing -- is that this is only the first of many requests. So, for example, today we have heard for the first time he wants evidence of our supposed allegation that his client paid promoters. Well, that's not an allegation in our complaint. We never alleged that. But it's a new one that he is suggesting we provide him documents for.

So I turn to the rules, because I think it's important, but I also turn to his own request where he asked us to produce the documents we had in the form that we kept them,

and that's what we did.

THE COURT: So he asked for --

MS. BROWN: He asked for --

THE COURT: What he's complaining about is precisely I what he asked for?

MS. BROWN: Yes. That asked that we produce ESI in the form that we maintained them, and that's what we did. In fact, we told him, consistent with the rules, that we were producing it in that form in a searchable format.

You have not heard him say that all of these documents are not searchable, because they are. So what I fear here is that we were turning the rules on their heads to create a situation where if the producing party has thousands and thousands and thousands of documents, as I admit we do, then the other side just gets to throw up their hands and say it's too expensive for us to look through them, and you tell us where the documents are that we want.

THE COURT: Is it true that the index for this case is 11,000 pages?

MS. BROWN: No, it is not. The index I attached to my letter, your Honor. It was produced by our systems but redone by me to give them what they wanted, which is a Bates number range for every single producing party.

So for example, if he wanted to know where his broker was and figure out what those documents were, I invited him to

do that. And let's not forget that I invited him, before he even made his request, to tell me what he was interested in, and he chose to serve a request that asked for everything we have.

THE COURT: In the manner in which you --

MS. BROWN: In the manner in which we kept them.

THE COURT: Mr. Richard, is anything that she said inaccurate.

MR. RICHARD: Virtually everything that she said is inaccurate.

THE COURT: Did she offer to give you the Bates numbers for the documents concerning -- I forget the particular issue.

MR. RICHARD: With a significant condition, which she omitted. First she declined to tell me where they were, then she gave me 20,000 pages that I could look at to find them, then finally she said that if I agreed to withdraw this letter motion and not come to this hearing on the other issues and I just accepted a single matched trade that she was going to show me, even though it's not on the complaint, then she would show if to me, but otherwise she would not. So I wouldn't call that completely accurate.

We have served since then two interrogatories within the rule, and we have also been told they're not going to answer these interrogatories in which we asked them to identify

the specific Bates numbers of where these matched trades are and the specific payments of where the evidence -- I know counsel just said that they did not allege that Brauser made these payments. I can tomorrow file something with the Court quoting the page, chapter, and verse where they allege that so that I just -- we're not seeking a lot here, and what we're seeking is we have a series of categories of information, all of which are tied to the allegations in the complaint.

THE COURT: Let me ask you this, she said also you're complaining that you received these materials in the manner apparently in which the SEC received it, but she says that that's the way you asked for it. Is that inaccurate?

MR. RICHARD: That is inaccurate. What she's doing is conflating "received" with how they're kept in the ordinary course, and the cases talk about this, too. We didn't ask for it as received over the last three years for 220 sources, we asked for them to show it to us as they keep it.

They're not denying that over the years in order to make the claims against my client they went through all of these documents, these millions of pages of documents from these 220 sources and they have organized them in some fashion, they just want us to have the disorganized fashion that they received them in over several years. So there's a distinction. What the rule says is --

THE COURT: I get it. I listen very carefully to what

people tell me, and when someone tells me X and other person tells me Y, I try to determine: Is someone not being completely truthful or accurate or careful enough? Which is why I have been going back and forth and asking you very specific questions about precisely what she said.

So let me go to you again, Ms. Brown. How did he request these documents?

MS. BROWN: I'm reading from Exhibit A of my letter to you, which is their document request, and it says: Unless the parties agree otherwise, all electronically stored information shall be produced in the form in which it is kept in its usual course. And that is how we produced it.

I think Mr. Richard doesn't believe me that we keep the documents according to producing party the way they were produced to us, but we do. And so we have to search for them. If we need something, we have to search for them.

Your Honor, there's a time and a place for exchanging trial exhibits and exchanging contention interrogatories, and I'm happy to talk about that, and to do that at that time, but this isn't it.

THE COURT: Okay. Your request is denied, Mr. Richard.

I think that's it. I need to go. We're adjourned.

MS. BROWN: Thank you.

MR. RICHARD: Thank you.